

SURREBUTTAL TESTIMONY OF

DAVID M. HERPEL, CPA

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2021-324-WS

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

2 A. My name is David M. Herpel. My business address is 1401 Main Street, Suite 900,
3 Columbia, South Carolina, 29201. I am employed by the South Carolina Office of
4 Regulatory Staff (“ORS”) as an Audit Manager.

5 **Q. DID YOU FILE DIRECT TESTIMONY AND EXHIBITS RELATED TO THIS**
6 **PROCEEDING?**

7 A. Yes. I filed direct testimony with the Public Service Commission of South Carolina
8 (“Commission”) on February 24, 2022.

9 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY IN THIS**
10 **PROCEEDING?**

11 A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of
12 Kiawah Island Utility, Incorporated (“KIU” or “Company”) Witness Burkett relating to
13 ORS Adjustment 19 for the calculation of KIU’s cash working capital allowance.

14 **Q. PLEASE EXPLAIN ORS ADJUSTMENT 19.**

15 A. In my direct testimony, ORS accepted the Company using a 45-day allowance to
16 calculate cash working capital. However, ORS proposed to remove pro forma adjusted

1 purchased water in the amount of \$3,485,070 and per book bad debt expense in the amount
2 of \$3,279 from the ORS cash working capital allowance calculation.

3 **Q. WHAT DID COMPANY WITNESS BURKETT PROPOSE IN HIS REBUTTAL**
4 **TESTIMONY IN RESPONSE TO ORS?**

5 A. Company Witness Burkett reaffirmed the Company’s calculation of cash working
6 capital using a 45-day allowance which includes pro forma adjusted purchased water and
7 per book bad debt expense in the calculation. Company Witness Burkett disagrees with
8 ORS’s direct testimony regarding the applicability of energy utilities excluding purchased
9 power from their 45-day cash working capital calculation being applied here for purchased
10 water. Witness Burkett mentions NARUC guidance and justifies his reasoning by stating
11 that the key to why the FERC, in a 1949 case example, excluded purchased power from
12 the calculation was because the purchased power was not paid until after revenues were
13 received by energy utilities from their customers.¹ Witness Burkett argues that this same
14 rationale cannot be applied to KIU’s 45-day cash working capital calculation because “KIU
15 pays its water bill before fully billing its customers for water.”² Company Witness Burkett
16 continues by describing the billing process for KIU by giving the example that St. Johns
17 Water Company (“SJWC”) invoices KIU at the beginning of March for February’s
18 purchased water, which is due March 15th. In his example, he states that KIU customers
19 would be billed in cycles throughout March, for the February SJWC water bill, with
20 respective payments due from the customers within “26 days.”³

¹ Company Witness Burkett Rebuttal Testimony, Page 3, Lines 10-11.

² Company Witness Burkett Rebuttal Testimony, Page 3, Lines 12-13.

³ Company Witness Burkett Rebuttal Testimony, Page 3, Line 18.

1 **Q. DOES COMPANY WITNESS BURKETT'S REBUTTAL TESTIMONY**
2 **REGARDING THE COMPANY'S INCLUSION OF PURCHASED WATER IN**
3 **THE CASH WORKING CAPITAL CALCULATION CHANGE YOUR**
4 **RECOMMENDATION?**

5 A. No. Regarding the removal of purchased water, ORS does agree with KIU Witness
6 Burkett that jurisdictions vary when it comes to the inclusion or exclusion of purchased
7 water in the calculation of cash working capital when using a 45-day allowance. ORS cited
8 Pennsylvania and North Carolina as examples of jurisdictions that exclude purchased water
9 from the 45-day cash working capital calculation.

10 ORS issued discovery to KIU based upon Company Witness Burkett's rebuttal
11 testimony that KIU pays its water bill before fully billing its customers for water. Based
12 on review of the discovery responses, KIU has four billing cycles in a month. For three of
13 the four billing cycles, a portion of revenue is collected from customers for water used
14 during the cycles prior to KIU having to pay SJWC for the water consumed during those
15 cycles. This supports that there is not a 45-day lag between the time KIU pays the SJWC
16 invoice and when KIU receives its revenue from its customers for that invoiced water. In
17 fact, in certain instances the Company receives revenue from customers for purchased
18 water before KIU pays the corresponding bill from SJWC. This is one reason why
19 jurisdictions exclude purchased water and sewer from the calculation of cash working
20 capital when using a 45-day allowance methodology and is one reason why ORS excluded
21 purchased water from its calculation of cash working capital for KIU.

22 Based on ORS's review of KIU's actual billing cycles, ORS believes it would be
23 appropriate for KIU to conduct a lead-lag study and recommends that KIU do so prior to

1 its next rate case. A lead-lag study is a tool that utilities can use to accurately determine the
2 number of days that should be included in the cash working capital calculation. This is
3 important for KIU because purchased water is the Company's largest single operating
4 expense, and it is not clear without such a study what lag, if any, is appropriate.

5 **Q. DOES COMPANY WITNESS BURKETT'S REBUTTAL TESTIMONY**
6 **REGARDING THE COMPANY'S INCLUSION OF BAD DEBT EXPENSE IN THE**
7 **CASH WORKING CAPITAL CALCULATION CHANGE YOUR**
8 **RECOMMENDATION?**

9 A. No. Regarding the removal of bad debt expense, ORS does agree with KIU Witness
10 Burkett that jurisdictions vary when it comes to the inclusion or exclusion of bad debt
11 expense from the calculation of cash working capital. However, ORS continues to
12 recommend the exclusion of bad debt expense from the cash working capital calculation
13 when using a 45-day allowance because bad debt expense is a non-cash expense.

14 The calculation of cash working capital focuses on actual cash expenses. There are
15 no cash payments related specifically to bad debt expense that would require upfront
16 payment from the Company while waiting for revenues from customers. For the same
17 reasons, depreciation and deferred income taxes are excluded from the calculation of cash
18 working capital. ORS's position is supported by the treatise *Principles of Utility Corporate*
19 *Finance*, where it states: "expenses such as bad debts and other uncollectable accounts are
20 generally excluded when working capital allowances are estimated."⁴ Since KIU applies
21 the 45-day methodology to calculate its cash working capital allowance to all its operating

⁴ Leonardo Giacchino and Jonathan Lesser, *Principles of Utility Corporate Finance*, Public Utility Reports, Inc. (2011).

1 and maintenance expenses, the Company already receives an allowance for those expenses.
2 Bad debt expense is comprised of a portion of the same expenses the 45-day methodology
3 is applied to calculate cash working capital.

4 **Q. WILL YOU UPDATE YOUR SURREBUTTAL TESTIMONY BASED ON**
5 **INFORMATION THAT BECOMES AVAILABLE?**

6 A. Yes. ORS fully reserves the right to revise its recommendations via supplemental
7 testimony should new information become available not previously provided by the
8 Company, or other sources, becomes available.

9 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

10 A. Yes, it does.